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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

Docket No. 71-347

WALTER HOLYK, KENNETH H. DARKE and
RICHARD H. CLAYTON,

Petitioners,

-against-

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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PETITIONERS' REPLY BRIEF

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Introductory Statement

In the main, the petition of Messrs. Clayton, Holyk and Darke consider the issues raised by the SEC in its opposing brief. Thus, this reply will be limited to the issues

raised by the SEC regarding the question of remedy and, in particular, the remedy created to impose liability on Mr. Darke for profits made by others, the so-called "tippees". These issues concern questions of first impression which, we submit, should be resolved after a full review by this Court.

I

The issue concerning Mr. Darke's liability for profits of others.

The SEC, in its opposing brief, offers no independent justification for the order requiring Mr. Darke to make "restitution" for profits derived by his "tippees", profits in which Mr. Darke did not share (SEC Br. pp. 43-44). In support of this novel requirement, the SEC simply reiterates the language of the Court of Appeals (Pet. App. 229a; SEC Br. pp. 43-44). While this form of argumentation may be construed as a remarkable display of discretion, it may also be construed as an inability to provide legal justification for the creation of a remedy beyond the pale of the court.

The paragraph of the Court of Appeals opinion, from which the SEC quoted all but a few unessential words, reads:

> "As to the requirement that Darke make restitution for the profits derived by his tippees, admittedly more of a hardship is imposed. However, without such a remedy, insiders could easily evade their duty to refrain from trading on the basis of inside information. Either the transactions so traded could be concluded by a relative or an acquaintance of the insider, or implied understandings could arise under which reciprocal tips between insiders in different corporations could be given." (Pet. App. 229a)
> (Emphasis added)

The Court in devising this restitutionary requirement presumably acted under its general equity powers (Pet. App. 227a-228a), but nowhere does the Court cite any authority to show that an equity court has the power to compel one person to answer for the gains of another. Research of cases concerning restitution has disclosed no case where a person was required to return other than that which he wrongfully acquired. We submit that the requirement imposed on Mr. Darke cannot be characterized as restitution and must be characterized as a penalty.

The Court of Appeals rationalized its newly created remedy by saying "without such a remedy, insiders could

easily evade their duty to refrain from trading on the basis of inside information" (Pet. App. 229a). This contention, however, is merely a supposition without any factual basis in the record. This is apparent from the immediately following sentence which reads:

> "Either the transactions so traded could be concluded by a relative or an acquaintance of the insider, or implied understandings could arise under which reciprocal tips between insiders in different corporations could be given." (Pet. App. 229a)

None of the hypothetical situations against which the Court seems to be guarding are present here. But even if they did exist, it would be totally irrelevant, because the supposition that the remedy created is necessary to prevent insider trading in the described situations is not valid. The SEC is equipped to prevent this type of trading by seeking criminal sanctions against both tippor and tippee under Section 32(a) of the Act and injunctive relief under Section 21(e).* Judicial legislation, therefore, is not required to supplement these remedies nor is it desirable.

We submit that the remedy created to foist liability on Mr. Darke for profits of tippees cannot be justified on equitable principles nor principles of statutory

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* Securities Exchange Act of 1934, Section 32(a) (Pet. App. p. 237a); Securities Exchange Act of 1934, Section 21(e) (Pet. App. p. 236a).

construction. Moreover, the imposition of such an onerous liability should not be countenanced where the predicate for liability is based on a slight burden of proof.

In this enforcement proceeding, the SEC from the outset contended that it need not prove all the elements required in a suit for monetary damages (SEC Br. 27-28). This contention has been sustained with the result that the SEC has only borne the slight evidentiary burden required in prophylactic actions. Yet the order requiring Darke to pay tippees' profits, an order which at the very least is based on legal and not equitable principles, was based on the prophylactic burden of proof and not the burden required in a monetary damage action. We submit that before the principles of equity, as espoused by the SEC, embark on a new course, this Court grant a full review of the issues.

II

Issue of authority to grant other than injunctive relief.

Neither the SEC nor the courts below cited any authority directly supporting the power of the SEC in an enforcement proceeding to request, and the court to grant, relief other

than injunctive relief provided in Section 21(e). We concede that a court has the power to grant ancillary relief to assure the effectiveness of orders which it is authorized to make. For example, the appointment of a receiver to insure that the terms of its injunctive order will be effectuated. However, the employment of ancillary relief in connection with statutorily authorized injunctive relief cannot serve as a predicate for the granting of relief unconnected with injunctive relief.

To support the granting of non-ancillary relief the SEC and the courts below cited (a) civil actions under Section 27 of the Securities Exchange Act, i.e., Mills v. Electric Autolite Co., 396 U.S. 375 (1970) where appropriate relief would have to be fashioned by the court if the statute was to be effective; (b) actions under the Housing and Rent Act or the Emergency Price Control Act, i.e., United States v. Moore, 340 U.S. 616 (1951) where the statute authorized the issuance of "other orders" separate and distinct from injunctive orders; and (c) actions under the antitrust laws, i.e., Shine Chain Theatres, Inc. v. United States, 334 U.S. 110 (1948) involving an order of divesti-

ture where the violator received full consideration for property divested. The only pertinent case, as we stated in our petition, is Mitchell v. De Mario Jewelry, 361 U.S. 288 (1960).* There this Court approved of a payment order, for which no statutory provision was expressly made, on the grounds that such order was essential to effect the purposes of the statute under consideration. No such finding of necessity has been made in this case to justify a rejection of the plain wording of Section 21(e). Indeed, no facts were submitted in support of a finding of necessity. Accordingly, we submit that before Section 21(e) is effectively replaced by Section 27, and Section 32(a) relegated to oblivion, this Court grant a full review of the issues regarding the authority of courts to fashion remedies other than those provided by statute.

CONCLUSION

For the foregoing reasons, this petition for a writ of

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* Discussed at pages 11-20 in the Petition of Messrs. Clayton, Darke and Holyk.

certiorari should be granted.

November 23, 1971

Respectfully submitted,

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PETITION FOR REHEARING

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—against—

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR REHEARING

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OCTOBER TERM, 1971

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR REHEARING

Introductory Statement

Petitioners respectfully move this Court for an order vacating the denial of their petition for writ of certiorari, entered on December 20, 1971, and granting such petition. In support of this motion, petitioners state the following:

I

This Petition May Be Considered By The Full Court of Nine Justices

The petition for certiorari was denied on December 20, 1971, with Justice Blackmun dissenting.* Since then, two new Justices have become members of this Court. The full Court now has an opportunity to consider whether the remedy invoked to punish Kenneth Darke is legally sustainable.

Rule 58(2) of this Court provides that a petition for rehearing of an order denying certiorari may be filed where substantial grounds exist that were not previously presented to this Court. The grounds upon which petitioners rely are hereinafter set forth in point II. They concern three elements interwoven in the manifold decisions below and obfuscated by the plethoric comment attendant the Texas Gulf Sulphur case. These elements are: (i) Kenneth Darke, an individual, who unknowingly violated a law, lacking in clarity, from which violation he received no benefit; (ii) a violation of the securities law which is based on evidentiary findings challenged by the author, Judge Waterman, of the very Court of Appeals opinion which determined the violation; and (iii) a remedy created without precedent, but justified as necessary to cure insider conspiratorial conduct and applied here where no conspiratorial conduct was alleged or proven.

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* Justice Blackmun was of the opinion that certiorari should be granted to consider the order requiring Mr. Darke to restore profits made by tippees and the order enjoining Mr. Clayton.

II

This Court Should Reconsider The Basis For The Harsh Penalty Imposed on Kenneth Darke

The rights of Kenneth Darke have been submerged in the backwash of the resolution of issues of *major* importance to the financial community, the investing public and the SEC and, without this Court's aid, will be irrevocably lost. In focusing on the novel issues in the Texas Gulf Sulphur (TGS) litigation, the courts have cursorily treated the minor ones involving Mr. Darke, a relatively insignificant individual in the entire complex and exhaustive proceedings. Yet he is the one to whom the most severe punishment was meted out and, in our opinion, a victim of the gravest injustice.

Kenneth Darke has been ordered to "restore" $48,404.58 to TGS. This sum represents profits made by others purportedly on his recommendation to buy TGS shares. Kenneth Darke did not receive one cent of this amount or any other cognizable benefit from those who purchased TGS shares. Nonetheless, the court, without statutory authority or judicial precedent, has ordered Darke to personally pay such amount to TGS, and that order will go undisturbed if not modified by this Court.*

$48,404.58 is a large sum to some individuals and a staggering sum to most. If Mr. Darke is required to pay this penalty, he will be indentured to TGS for the remainder of his life. Fundamental principles of justice require that

---

* This Court in *Reliance Electric Company* v. *Emerson Electric Company*, 40 L. W. 4125 (1972) circumscribed the court's authority to go beyond the express language of the Securities Exchange Act of 1934 to recapture profits made by insiders. In ordering Mr. Darke, an insider, to restore tippees profits, the courts below greatly exceeded the bounds established by this Court in *Reliance*.

before this indentured state becomes a reality, the decision mandating this payment be closely scrutinized by this Court. This is especially so where, as here, an average person is caught in the gossamer web of governmental and judicial pronouncements in a rapidly expanding and highly sophisticated area of law; where liability is imposed without any direct evidence and upon only the flimsiest of circumstantial evidence; and where the court's stated justification for the remedy created has no application to the facts of this case.

Kenneth Darke was employed by TGS as a geologist; he was not an officer or director. His skills were practiced in the most remote areas of this hemisphere. This alone would suffice to render him unfamiliar with our securities laws and regulations without adding the fact that he is a resident and citizen of Canada.* The case against Mr. Darke turned on the fact that two persons, to whom he had recommended TGS shares as "a good buy" in December 1963, purchased TGS shares, together with a few of their acquaintances, on *March 30, 1964.* Neither Kenneth Darke nor any other person was called to testify at the trial regarding the facts surrounding the alleged violations by Mr. Darke. The only material introduced into the record on the trial were the depositions of Mr. Darke (Jt. A. 1694a)**; Nancy A. Brown (formerly Atkinscn) (Jt. A. 1605a); Madge B. Caskey (Jt. A. 1622a); Herbert W. Klotz (Jt. A. 1636a); and Stanley I. Westreich (Jt. A. 1650a).

Nancy A. Brown and her mother, Madge B. Caskey, were friends of Mr. Darke to whom he recommended TGS shares

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* Ignorance of the law, while concededly no defense in a criminal proceeding, should be a factor in determining a remedy in an equitable proceeding.

** "Jt. A." refers to the Joint Appendix of the Court of Appeals, a copy of which has been filed in this Court.

as "a good buy" for reasons totally unconnected with the TGS drilling results (Jt. A. 1698a-1702a). Messrs. Klotz and Westreich were friends of Nancy Brown and did not know Mr. Darke. Each person, including Mr. Darke, testified that no information regarding the drilling results was made available. No rebuttal evidence was submitted by the SEC.

A perusal of the depositions fails to disclose a scintilla of evidence to indicate that Kenneth Darke told anyone about the TGS drilling results. Indeed, Judge Waterman, who wrote the majority opinion in the first Court of Appeals decision, and Judge Anderson, concurring, did not believe that there had been any finding by the district court as to whether Mr. Darke, "expressly or by implication, transmitted to these outsiders and indication of the extremely favorable results of the drilling operation in which he was engaged. . . ." * (App. 94a fn. 16).**

The Court of Appeals, in its first decision, swept away the direct evidentiary findings of the district court (App. 33a), concentrating its vision on the district court's statement that the purchases on March 30, 1964, were strong circumstantial evidence that Darke must have passed the word to one or more of his tippees that "drilling on the Kidd 55 segment was about to be resumed." Building on this circumstantial evidence, the Court of Appeals then added a circumstantial finding of its own. It said "if such a resumption were to have any meaning to such 'tippees', they must have previously been told of K-55-1." (App. 94a)*** These conclusion were drawn without any direct evidence

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* Chief Judge Lombard and Judge Moore, of course, did not find any liability (129a-173a).

** "App." refers to petitioners' appendix in No. 71-327.

*** If Mr. Darke did communicate on March 30, why didn't he communicate on April 9, when the results were more definitive and extremely favorable.

that Mr. Darke communicated the resumption of drilling to his tippees or, as Judges Waterman and Anderson noted, anything about the drilling results. Hence, on the slender reed of purchases on March 30, 1964, liability was imposed on Kenneth Darke.

However slender the reed to impose liability, absolutely no meaningful basis was proffered for holding Mr. Darke accountable for the profits of others. Nowhere in our system of jurisprudence, apart from the law of agency, has anyone been held responsible for the acts of others unless he was acting in concert with them or knowingly acting in violation of the law. Neither condition obtains here. The Court of Appeals in its second decision acknowledged the hardship to Kenneth Darke by the payment order, but swiftly justified it saying:

> "without such a remedy, insiders could easily evade their duty to refrain from trading on the basis of inside information. Either the transactions so traded could be concluded by a relative or an acquaintance of the insider, or implied understandings could arise under which reciprocal tips between insiders in different corporations could be given." (App. 229a)

This justification has absolutely no application to the facts of this case. If an insider were to trade, as the court suggests, through a friend or acquaintance, or with implied mutually beneficial understandings, such transactions would constitute a conspiracy. Holding the tipper liable for tippees profits derived from a conspiratorial scheme is well recognized under existing principles of law. But no such allegation of conspiracy can be found in the complaint, nor can any facts of a conspiracy be gleaned from the direct or circumstantial evidence introduced at the trial. Thus for the court to fashion and apply a

remedy designed to cure conspiratorial conduct to this case, where no conspiracy exists, is clearly erroneous.

When the heat of the courtroom battle subsides and the final decision is rendered, it remains for the result to be tested by the sound principles of law or equity developed over the past centuries. This test is not met in this equitable proceeding, where no principle has been enunciated to rationalize, or precedent cited to support, a result which on its face is unfair, unjust, and destructive of personal rights. Before we embark on a new tenet of law which subjugates an individual to unconscionable debt, this Court should pass on it.

CONCLUSION

For these reasons, as well as those contained in the petition for a writ of certiorari, petitioners pray that this Court grant rehearing of the petition, and order a review of the judgments and opinions below.

Dated: January 14, 1972

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Certificate of Counsel

As counsel for the Petitioners, I hereby certify that the petition for rehearing is presented in good faith and not for delay, and to the extent described above, is restricted to the grounds specified in Rule 58(2).

.....

Attorney for Petitioners